



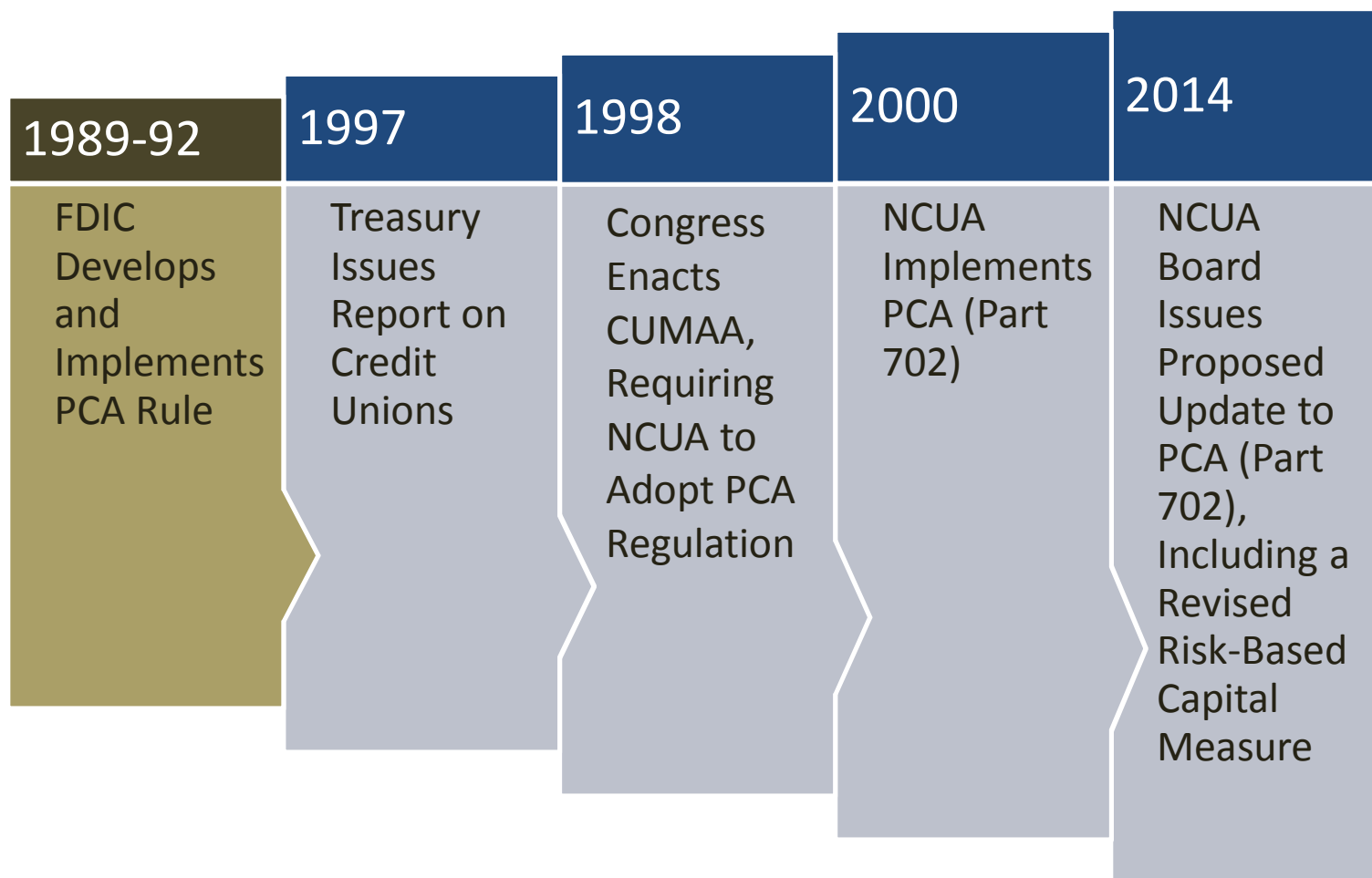
Risk-Based Capital Webinar

January 21, 2015

Agenda

- Risk-Based Capital History
- Process for Updating the Rule
- Overview of Proposed Rule Revisions
- Impact of Changes
- Next Steps
- Q & A

Risk-Based Capital History



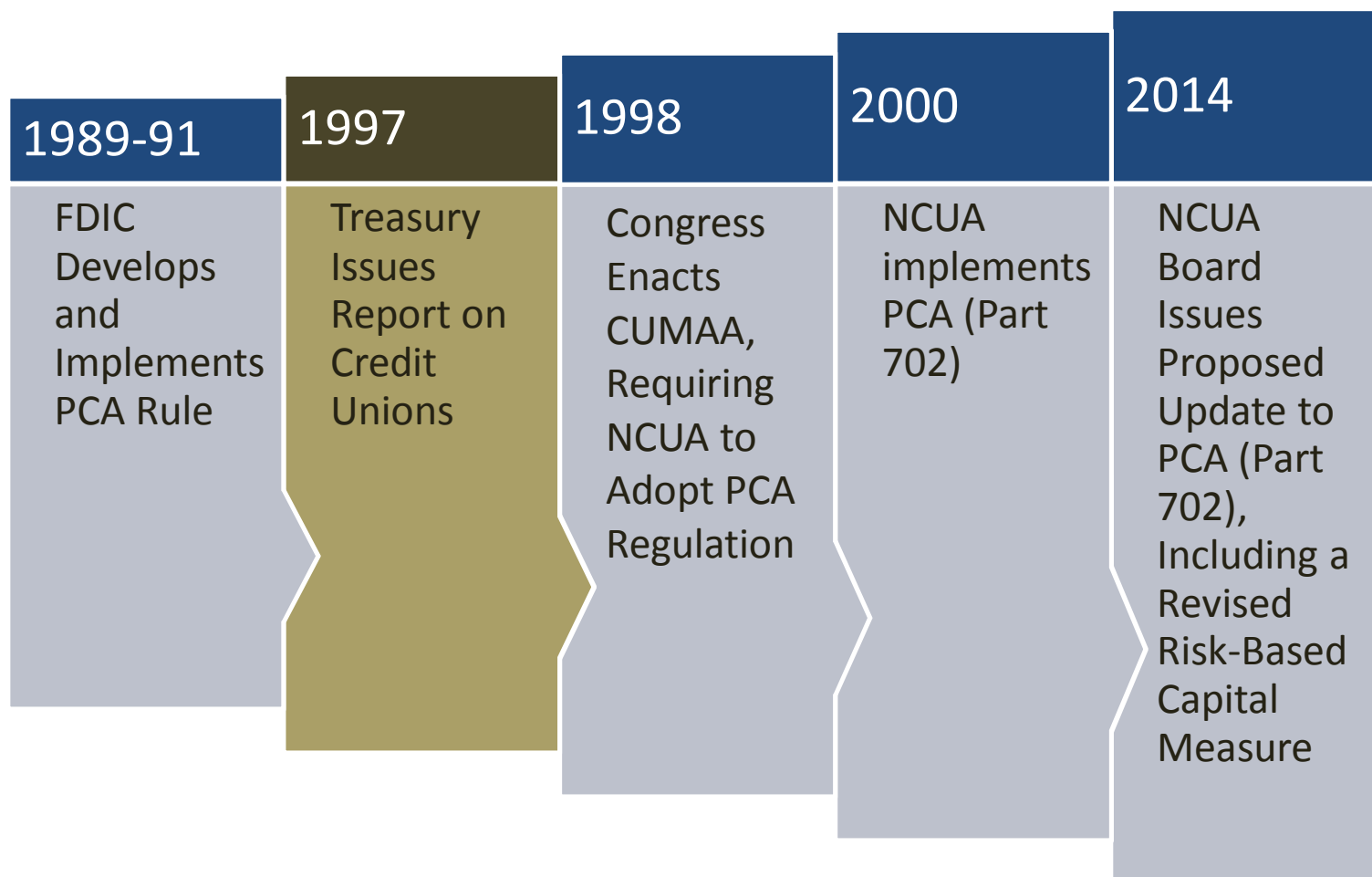
Risk-Based Capital History

1989-92

FDIC
Develops
and
Implements
PCA Rule

- **Leverage (Net Worth) Ratio = Capital (Net Worth)/Assets**
- **Leverage ratio is a lagging indicator.**
- **Risk-based capital measure included to account for risks where the leverage ratio may be insufficient.**

Risk-Based Capital History



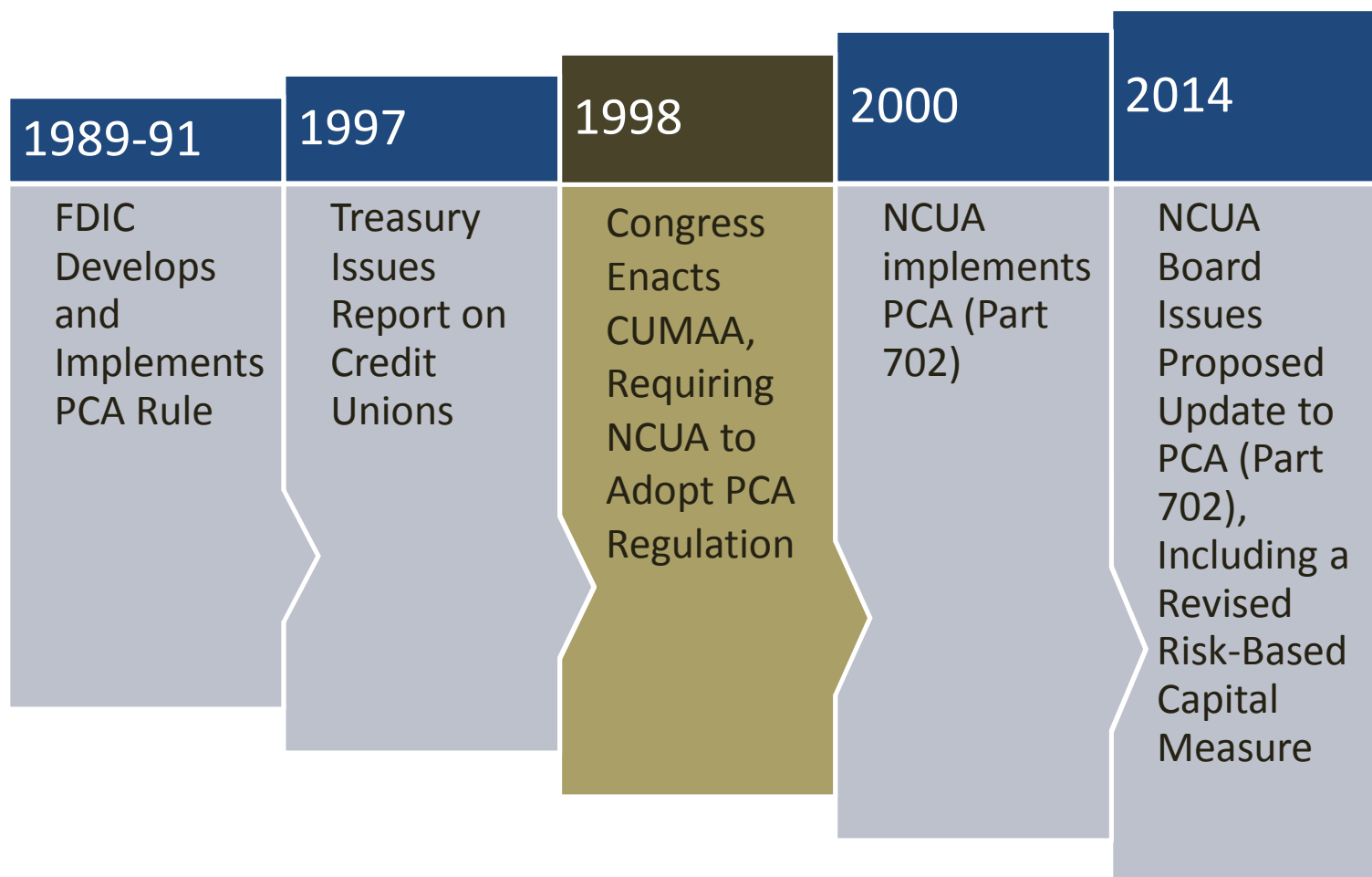
Risk-Based Capital History

1997

Treasury
Issues Report
on Credit
Unions

- **Recommendations included in the report**
 - Require a system of prompt corrective action designed to ensure credit unions correct any net worth deficiency expeditiously
 - Raise the reserve target to 7% of total assets
 - Deduct from reserves some portion of corporate capital
 - Require NCUA to develop an appropriate risk-based net worth requirement for large, more complex credit unions to supplement the simple net worth requirement and to take account of risk

Risk-Based Capital History



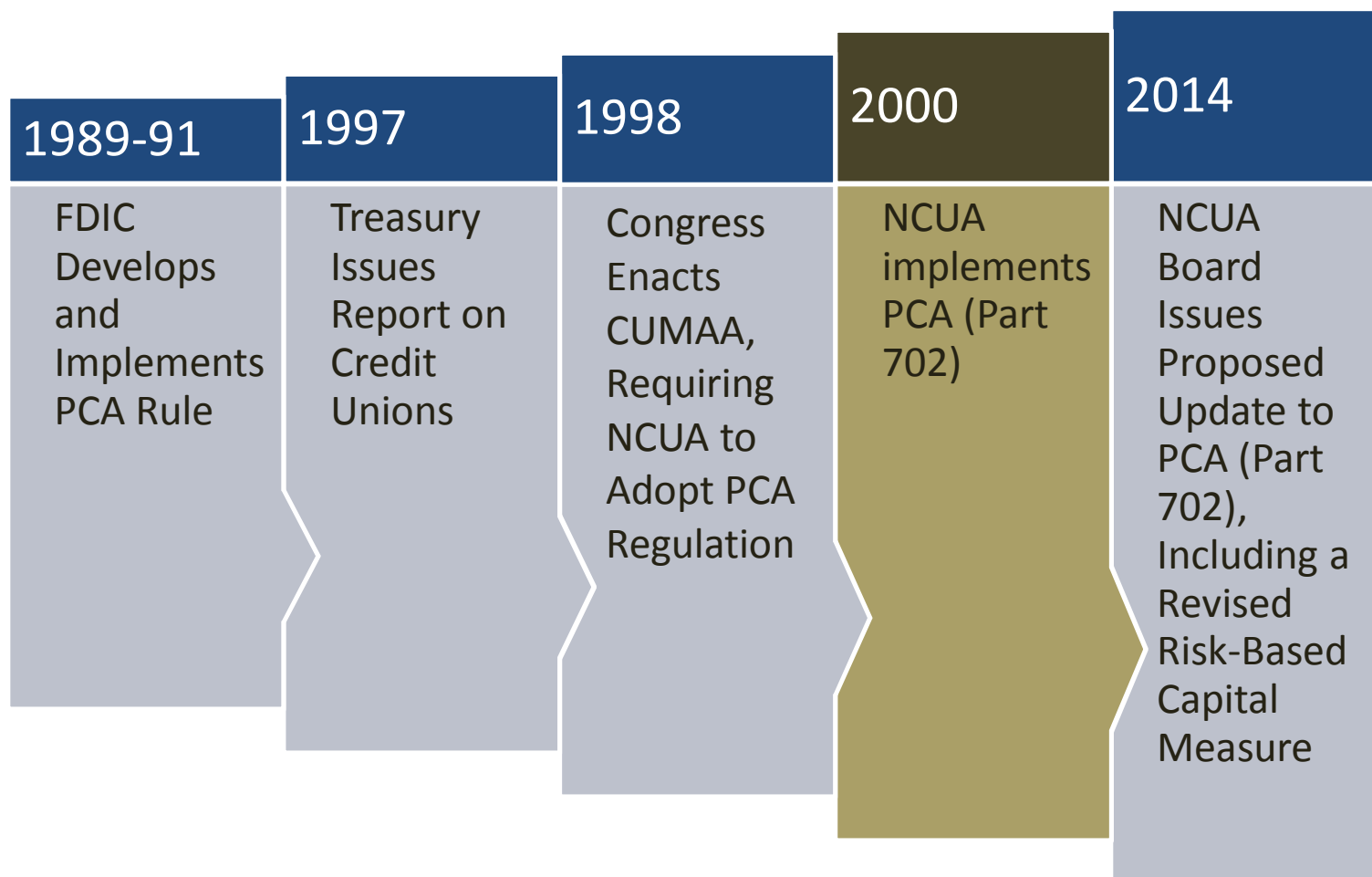
Risk-Based Capital History

1998

Congress
Enacts
CUMAA,
Requiring
NCUA to
Adopt PCA
Regulation

- Included a PCA framework for credit unions based on the 1997 Treasury report
- **Net Worth Ratio = 7%**
 - NCUSIF deposit is recorded on both credit union's and NCUSIF's financial statements
 - Inability to increase net worth quickly
 - Corporate capital

Risk-Based Capital History



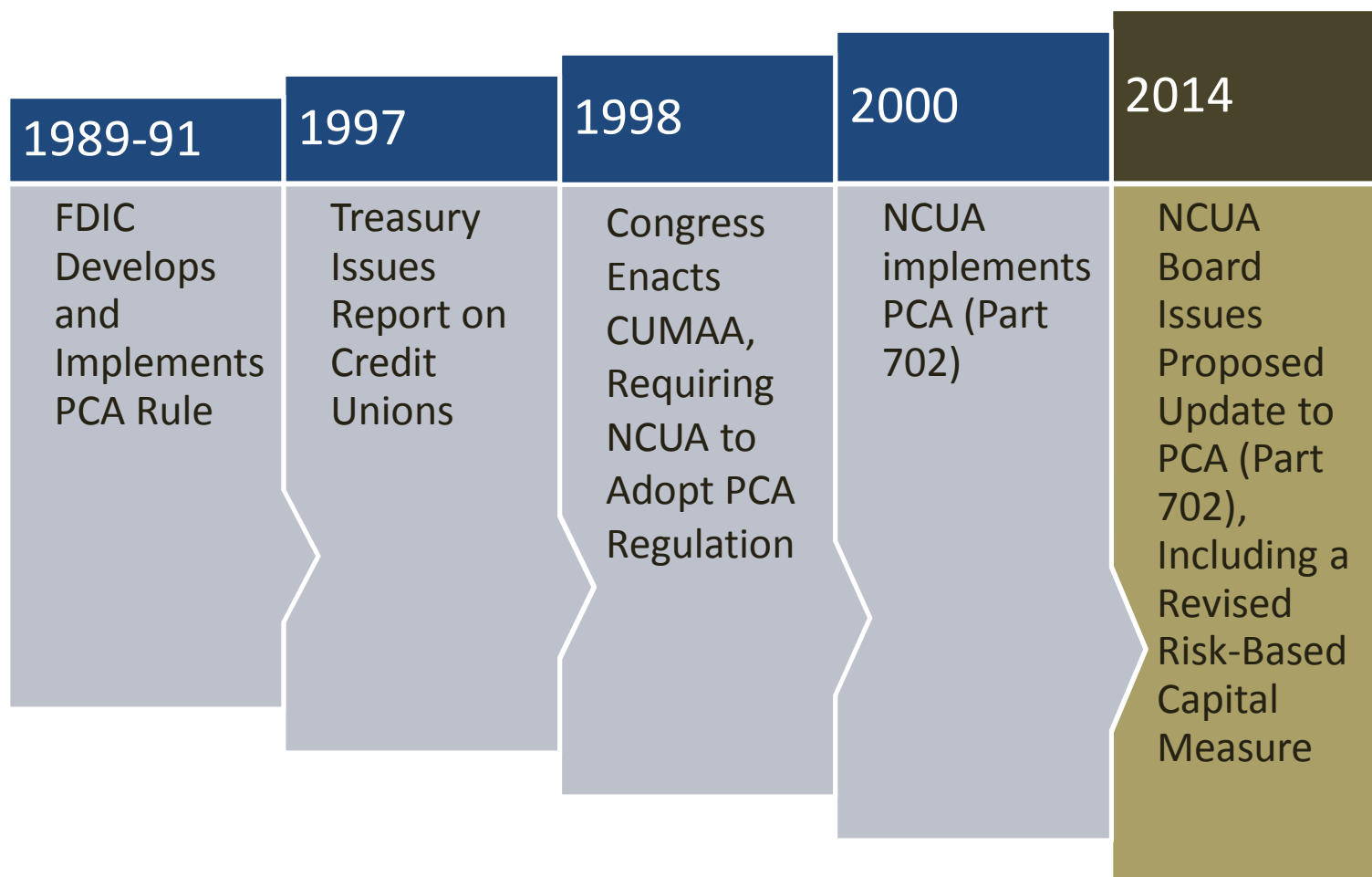
Risk-Based Capital History

2000

NCUA
implements
PCA (Part
702)

- **Net Worth Ratio = Net Worth/Assets**
- **Included risk-based net worth component**
 - Only applicable to credit unions with assets greater than \$10 million
 - Changed to credit unions with assets greater than \$50 million in 2013
- **Currently, only two credit unions fail the RBNW requirement outlined in this rule**

Risk-Based Capital History



Risk-Based Capital History

2014

NCUA Board
Issues
Proposed
Update to
PCA (Part
702),
Including a
Revised Risk-
Based Capital
Measure

- **Comparable to other banking agencies' rules**
- **Reflected riskiness of assets more accurately than leverage ratio**
- **Addressed Government Accountability Office and NCUA Inspector General recommendations**
- **Addressed outliers**
- **Incorporated lessons learned**

Process to Issue 2014 Proposal



FCU Act Mandates

- **FCU Act Section 216(b)(1)(A)**
 - *“The Board shall, by regulation, prescribe a system of PCA for insured credit unions that is (i) consistent with this section; and (ii) comparable to section 1831o of this title.”*
- **The Senate report defines comparable as**
“parallel in substance (though not necessarily identical in detail) and equivalent in rigor.”

FCU Act Mandates

- **FCU Act Section 216(b)(1)(B)**
 - *The Board shall design a system required under subparagraph (A) to take into account that credit unions are not-for-profit cooperatives that:*
 - *do not issue capital stock;*
 - *must rely on retained earnings to build net worth; and*
 - *have boards of directors that consist primarily of volunteers.*

FCU Act Mandates

- **FCU Act Section 216(d)(2)**
 - *“The Board shall design the risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union to be adequately capitalized may not provide adequate protection.”*
- **The Senate report further states:**
 - *“Thus the NCUA should, for example, consider whether the 6 percent requirement provides adequate protection against interest-rate risk and other market risks, credit risk, and the risks posed by contingent liabilities, as well as other relevant risks.”*

After 2014 Proposal was Approved

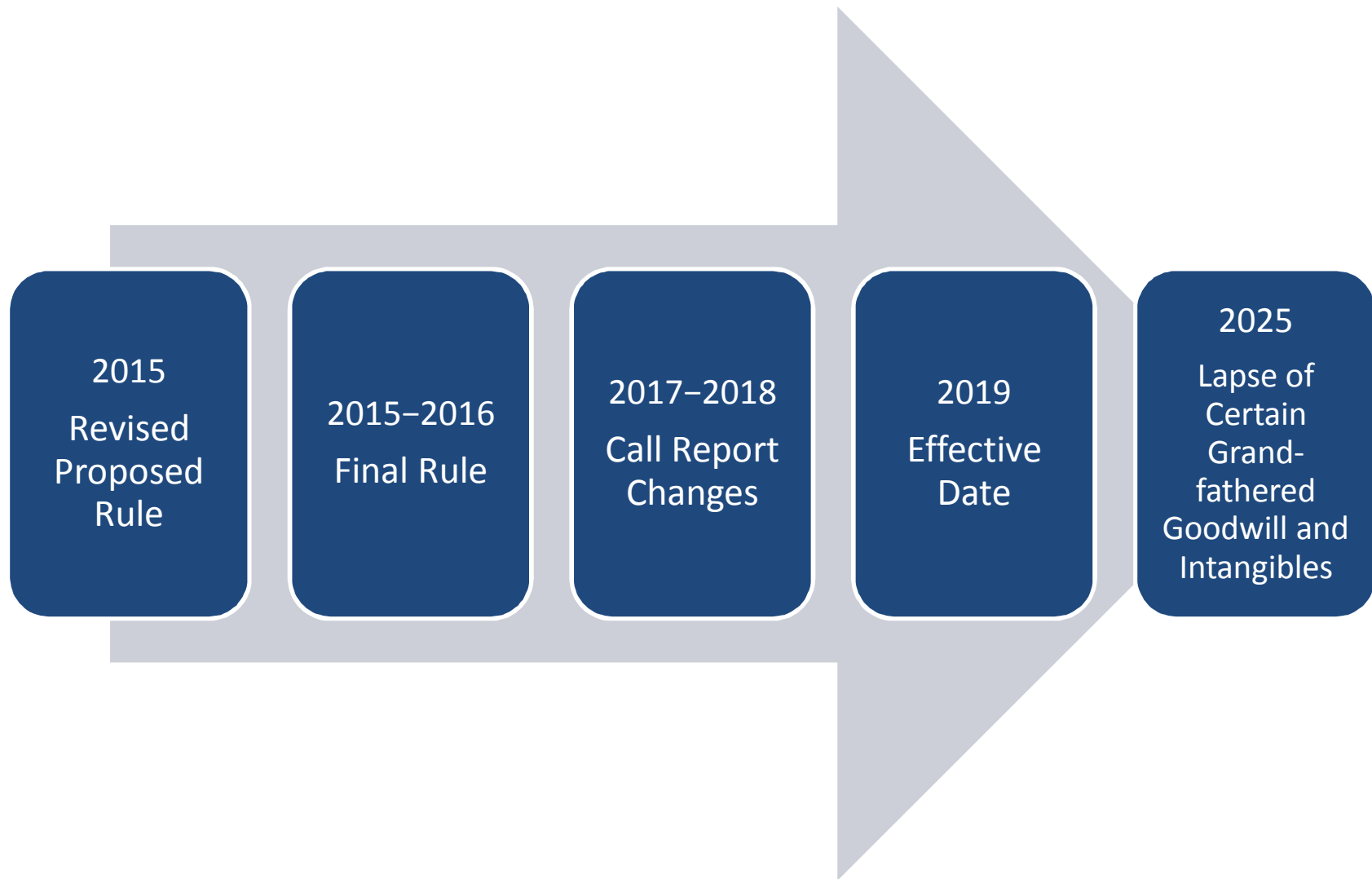
Listening Sessions

Written Comments

Credit Union Practitioners Group

KEY CHANGES TO REVISED PROPOSED RULE

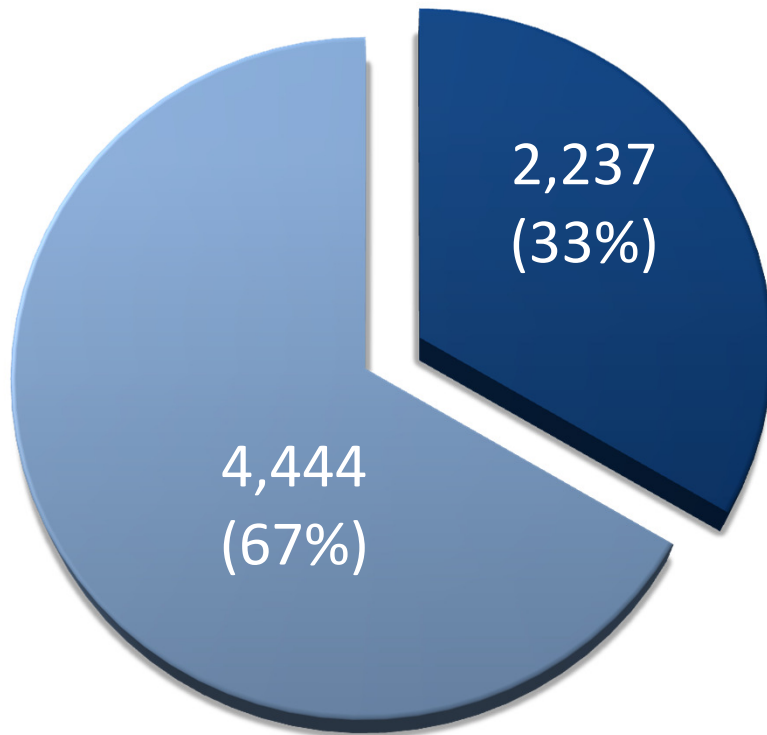
Extended Implementation Period



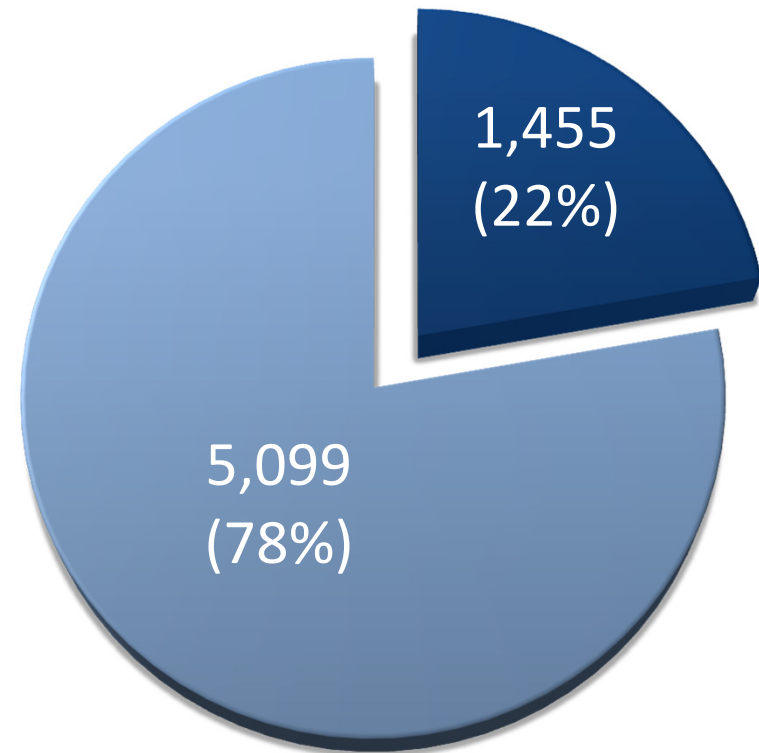
Reduced Number of Complex Credit Unions

Original Proposed Rule
(\$50 million)

■ Complex
■ Non-Complex

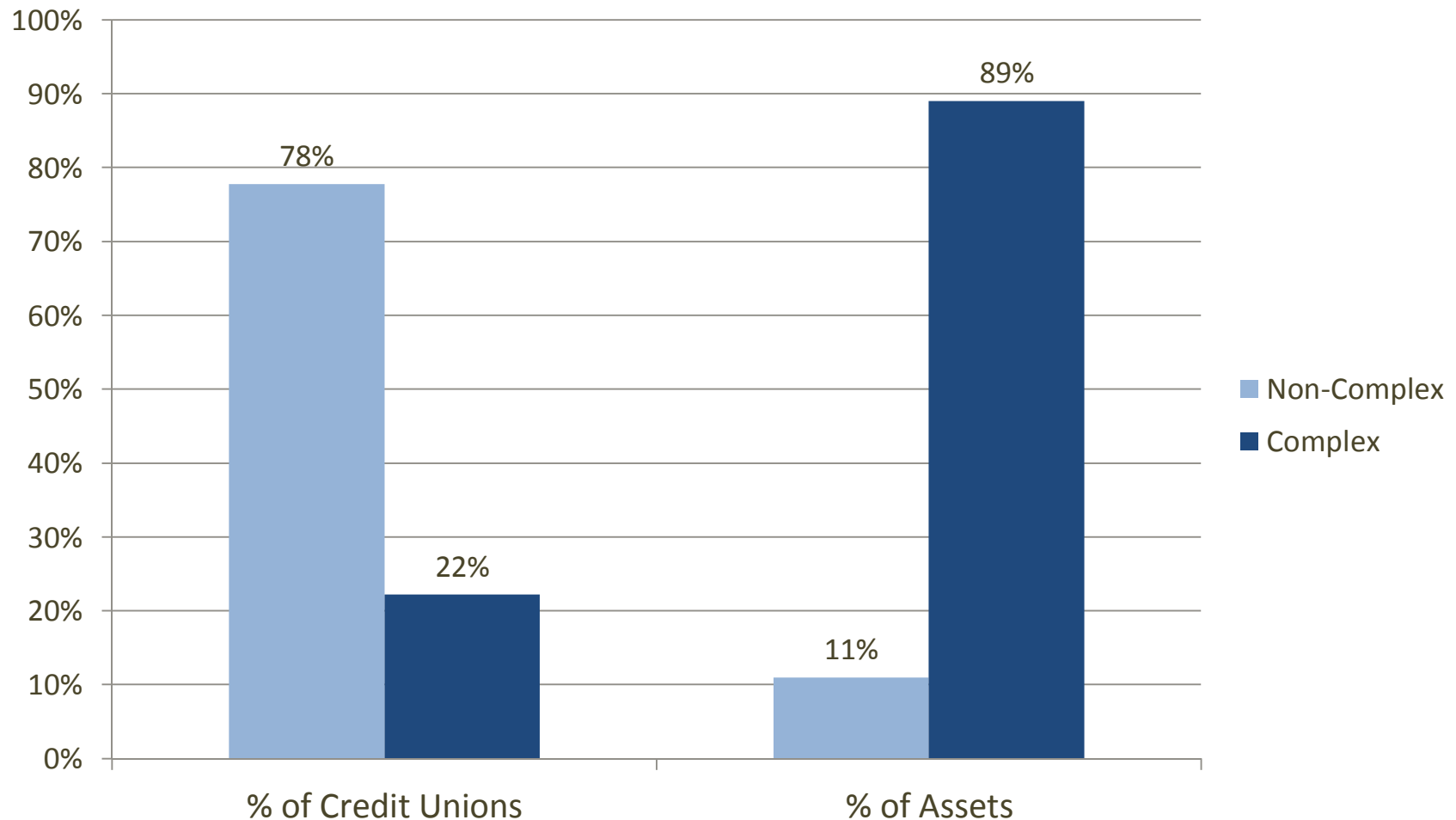


Revised Proposed Rule
(\$100 million)



Reduced Number of Complex Credit Unions

Complex Threshold Increased to \$100 Million in Assets



Reduced Risk-Based Capital PCA Threshold

	Original Proposal	Revised Proposal	Bank Rule
Well-Capitalized Risk-based capital measure	10.5%+	10.0%+	10%+
Adequately Capitalized Risk-based capital measure	8% - 10.49%	8% - 9.99%	8% - 9.99%*
Undercapitalized Risk-based capital measure	< 8%	< 8%	< 8%

*Banks also have to hold 2.5% capital conservation buffer by full implementation in January 2019

Removed Interest Rate Risk from Risk Weights

- This primarily impacts investment risk weights
- Preamble requests comments on alternative approaches that could be taken to account for interest rate risk
 - The Board agrees interest rate risk measures should be based on both assets and liabilities

Amended Concentration Risk Thresholds

- Concentration risk is included in the current risk-based net worth rule; removing it would be a step backwards
- Concentration thresholds are only set for first-lien real estate loans, junior-lien real estate loans, and commercial loans
- Government Accountability Office and NCUA Inspector General recommended inclusion
- Consolidated to a single, higher threshold tier that targets material outliers

Reinforced Need for Capital Adequacy

- **Added requirement for a complex credit union to:**
 - Maintain capital commensurate with all risks to which the institution is exposed
 - Have a process for assessing its overall capital adequacy in relation to its risk profile
 - Develop a comprehensive written strategy for maintaining an appropriate level of capital
- **Codifies long-standing supervisory expectations**

Removed Individual Minimum Capital Requirement Provision

- **NCUA will address capital deficiencies through:**
 - Reclassification under section 702.102(b) per section 216(h) of the Federal Credit Union Act
 - Other supervisory authorities to address unsafe and unsound conditions or practices under section 702.1(d)
 - Proposed capital adequacy provision under section 702.101(b)

Risk-Based Capital Ratio Numerator

Capital Elements

Undivided Earnings

Net Income

Other Reserves

Secondary Capital and 208 Asst. Included in NW

Appropriation for Non-Conforming Investments

Equity Acquired in Merger

ALLL

Numerator Deductions

NCUSIF Capitalization Deposit

Identified Losses not
Reflected in RBC Ratio
Numerator

Goodwill

Other Intangible Assets

$$\text{Risk-Based Capital Ratio} = \frac{\text{Capital Elements} - \text{Numerator Deductions}}{\text{Total Risk-Weighted Assets}}$$

Removed Cap on ALLL

Current Rule	Original Proposal	Revised Proposal	Bank Rules
Capped at 1.5% of Loans	Capped at 1.25% of Risk Assets	No Cap	Capped at 1.25% of Risk Assets

- Removing the cap eliminates concerns with possible change in ALLL accounting guidance
- Rule will provide emphasis that ALLL must comply with GAAP

No Change to Supplemental Capital

- Secondary capital is included for low income credit unions
- Capital treatment, investor suitability, consumer protection beyond the scope of this rule
- Board requests advance comments on types of supplemental capital to include in RBC* and the other regulatory provisions that would be necessary

*Statutory change necessary to include in net worth ratio

Grandfathering Supervisory Merger Goodwill & Other Intangibles

	Original Proposal	Revised Proposal	Bank Rules
Goodwill	-100%	-100%	-100%
Other Intangible Assets (excludes goodwill and other servicing assets)	-100%	-100%	-100%

- **Special handling for allowing goodwill and other intangibles related to supervisory mergers (as reported per GAAP) incurred prior to publication of a final rule; phase-out date January 2025.**

Retained Treatment of NCUSIF Deposit

Original Proposal	Revised Proposal	Bank Rules
-100%	-100%	n/a

- **Deducting from both the numerator and denominator is consistent with Congressional and U.S. Treasury views and the 2012 GAO study.**
 - Addresses concerns with the deposit existing on both the credit union's and NCUSIF's financial statements.

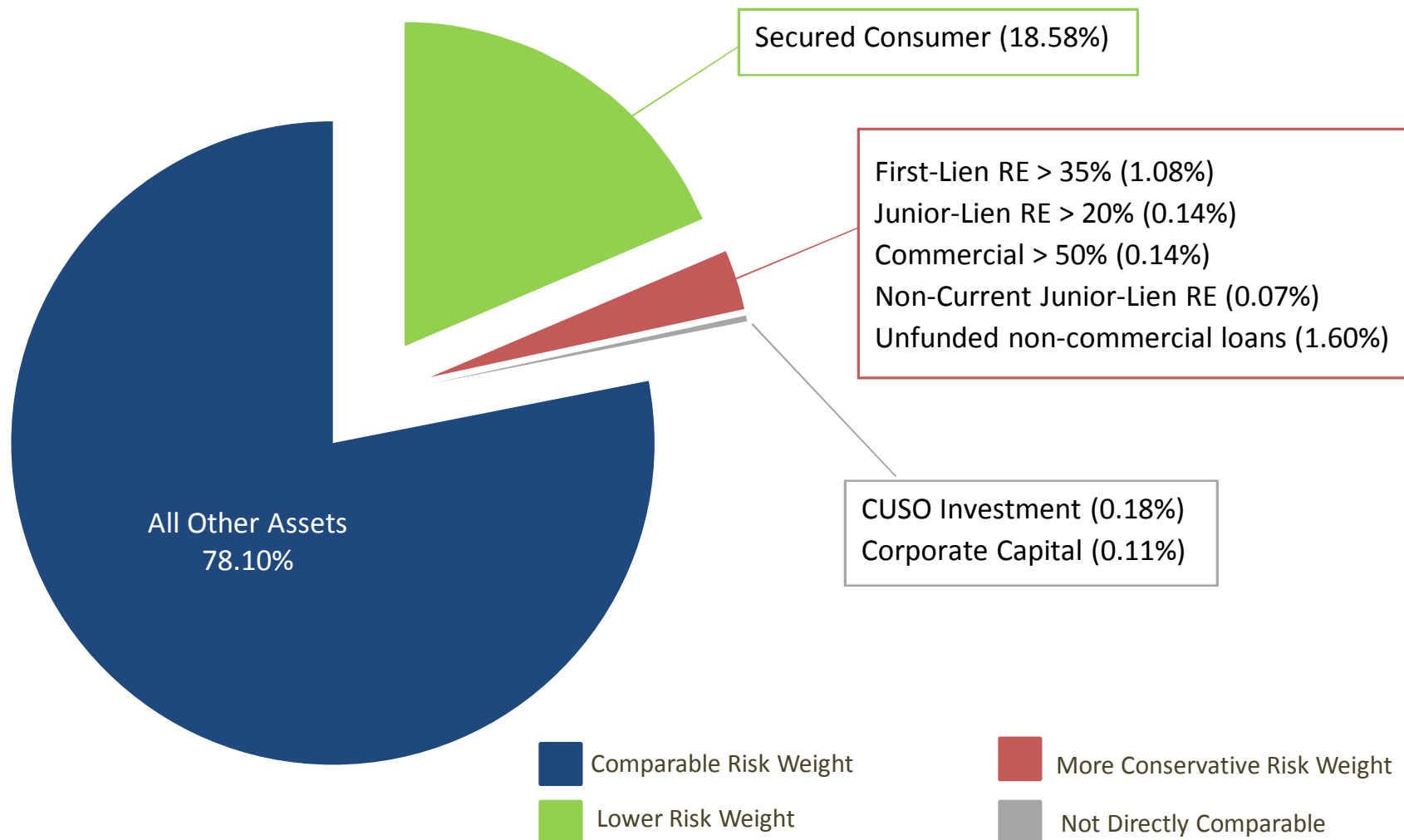
Risk-Based Capital Ratio Denominator

$$\text{Risk-Based Capital Ratio} = \frac{\text{Capital Elements} - \text{Numerator Deductions}}{\text{Total Risk-Weighted Assets}}$$

Total Risk-Weighted Assets = Risk-Weighted On-Balance-Sheet Items + Risk-Weighted Off-Balance-Sheet Items + Risk-Weighted Derivatives – Numerator Deductions

Risk Weight Comparison

(As a % of Complex Credit Union Assets)



Variances from Bank Risk Weights

	% of Assets	Revised NCUA Risk Weight	Bank Risk Weight
Secured Consumer Loans	18.58%	75%	100%
Off-Balance Sheet – Unfunded Non-Commercial Commitments	1.60%	75% or 100%	0% Unconditionally Cancelable
First-Lien Residential Real Estate Loans Greater than 35% of Assets	1.08%	75%	50%
Junior-Lien Residential Real Estate Loans Greater than 20% of Assets	0.14%	150%	100%
Commercial Loans Greater than 50% of Assets	0.14%	150%	100%
Non-Current Junior-Lien Residential Real Estate Loans	0.07%	150%	100%
CUSO Investment	0.18%	150%	100%-600%
Corporate Capital	0.11%	100% & 150%	100%-600%

Cash

	Original Proposal	Revised Proposal	Bank Rules
Cash, Currency, Coin	0%	0%	0%
Cash on Deposit in Transaction Account	20%	n/a*	n/a*
Cash Items in Process of Collection	20%	n/a*	20%
Balances due from Federal Reserve Banks	20%	0%	0%
Insured Deposits in U.S. Federally Insured Depository Institutions	20%	0%	0%
Uninsured Deposits in U.S. Federally Insured Depository Institutions	20%	20%	20%
Cash Equivalents (Investments with Maturities less than 3 months)	20%	n/a**	n/a**

*The rule accounts for deposits as insured or uninsured for risk weight purposes.

**The rule captures cash equivalents as either an investment or deposit product and applies the risk weight treatment as applicable.

Investments

- **Removed interest rate risk from risk weights**
 - Amended risk weights to exclude weighted average life (WAL)
- **Created risk weight categories and weights comparable to other banking agencies**
- **Seeking comments on alternative approaches to interest rate risk**

Investment Risk Weights

0%

	Original Proposal	Revised Proposal	Bank Rules
Direct unconditional claims on U.S. Government (Treasury and GNMA)	0%	0%	0%
Debt instruments issued by NCUA and FDIC	0%	0%	0%
CLF stock	50%	0%	0%

Investment Risk Weights

20% & 50%

	Original Proposal	Revised Proposal	Bank Rules
Investment funds holding only 0%-20% risk weighted Part 703 permissible investments	WAL	20%	n/a
Agency obligations	WAL	20%	20%
General obligation bonds issued by state or political sub.	WAL	20%	20%
FHLB stock	50%	20%	20%
Senior, agency residential MBS or ABS structured securities	WAL	20%	20%
Revenue bonds issued by state or political sub.	WAL	50%	50%
Senior, non-agency residential MBS structured securities	WAL	50%*	**

*Non-subordinate

**FDIC is subject to Gross-Up or Simplified Supervisory Formula Approach

Investment Risk Weights

100% & 150%

	Original Proposal	Revised Proposal	Bank Rules
Corporate non-perpetual capital (membership capital)	100%	100%	250%
Senior, non-agency ABS structured securities	WAL	100%*	**
Industrial development bonds	WAL	100%	100%
Agency stripped MBS (interest only and principal only)	WAL	100%	100%
Value of General Accounts Permanent Insurance	WAL	100%	100%
Corporate perpetual capital (paid-in capital)	200%	150%	250%

*Non-subordinate

**FDIC is subject to Gross-Up or Simplified Supervisory Formula Approach

Investment Risk Weights

300% & above

	Original Proposal	Revised Proposal	Bank Rules
Separate Account Life Insurance	WAL	300%*	*
Publicly traded equity investment (non CUSO)	200%	300%	300%
Fair Value of Mutual Funds – Non-703 compliant	WAL	300%*	*
Non-publicly traded equity investment (non CUSO)	200%	400%	400%
Subordinated tranche of any MBS, ABS, or synthetic securities containing possible risk of loss of principal)	WAL	1,250%**	**

*The FDIC is subject to Look-Through Approach, NCUA has the option of using the Look-Through Approach

**FDIC is subject to Gross-Up or Simplified Supervisory Formula Approach, NCUA has the option of using Gross-Up Approach

Consumer Loans

	Original Proposal	Revised Proposal	Bank Rules
Current Fully Share Secured Loans	75%	20%	n/a
Government Guaranteed Portion of Loan Balances	20%	20%	20%
Current Secured Consumer Loans	75%	75%	100%
Current Unsecured Consumer Loans	75%	100%	100%
Current Non-Federally Insured Student Loans	100%	100%	100%
Non-Current Consumer Loans	150%	150%	150%

- **Threshold for non-current (delinquent) loans changed from 60 to 90 days past due**
- **Separate risk weights for fully share secured, secured, and unsecured consumer loans**

Residential Real Estate Loans

- **Revised definition**
 - Includes all 1 to 4 family homes*
 - If both junior lien and first lien is held by the credit union, the loans can be combined and the entire balance included in the risk weight for a first-lien residential real estate loan
- **Ability to Pay**
- **Government guarantees**

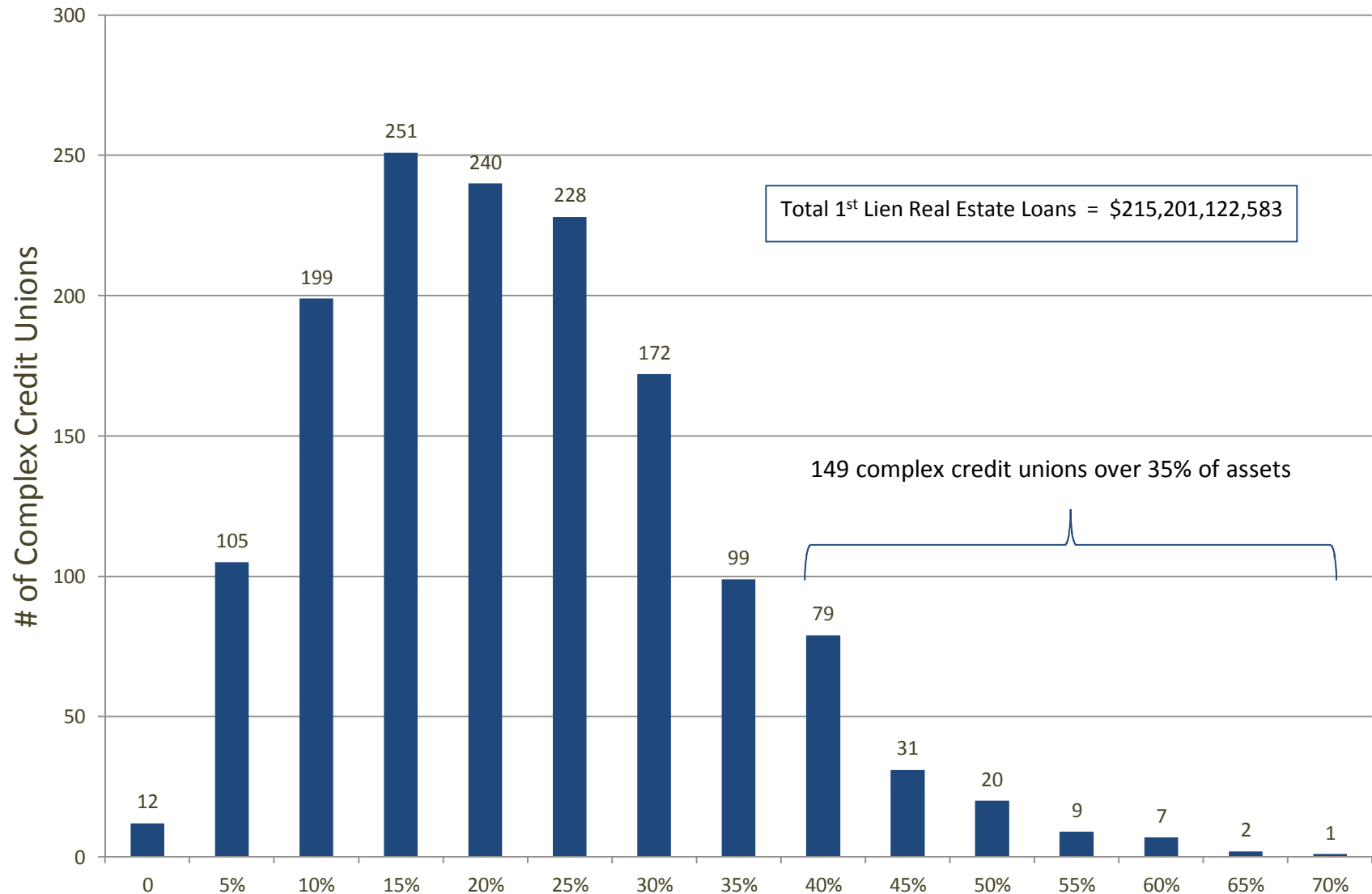
*Does not change inclusion of non-owner occupied real estate loans as MBL for statutory cap

Residential Real Estate Loans

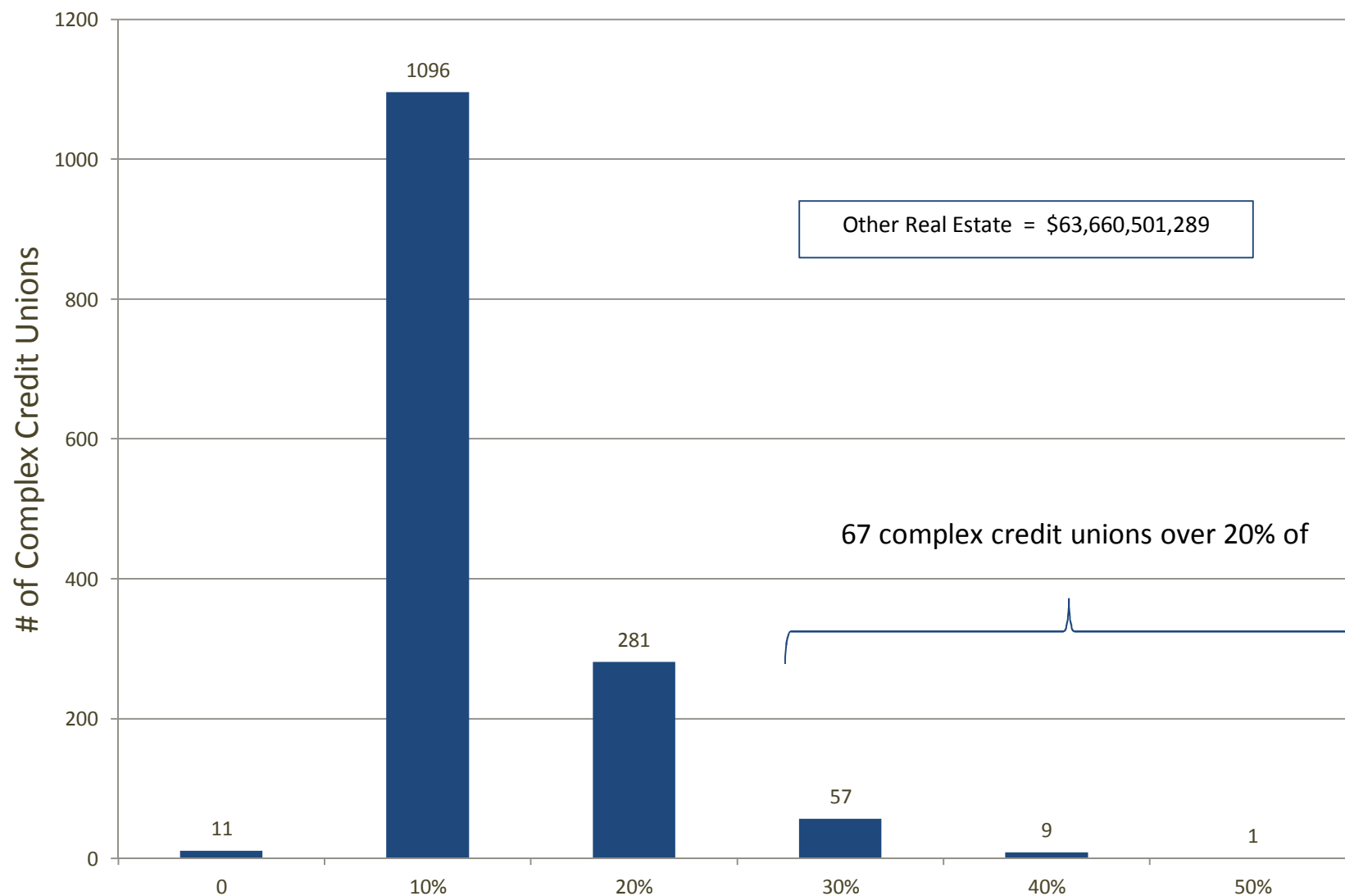
	Original Proposal	Revised Proposal	Bank Rules
Current 1 st Lien RE Loans < 35% of Assets	50% < 25% of Assets: 50% 25% to 35% of Assets: 75%	50%*	50%
Current 1 st Lien RE Loans > 35% of Assets	> 35% of Assets: 100%	75%*	50%
Non-Current 1 st Lien RE	100% (treated as junior lien and subject to concentration thresholds)	100%	100%
Current All Junior-Lien RE Loans < 20% of Assets	< 10% of Assets: 100% 10-20% of Assets: 125%	100%*	100%
All Junior-Lien RE Loans > 20% of Assets	> 20% of Assets: 150%	150%*	100%
Non-Current Junior-Lien RE Loans	100%	150%	100%

*Includes all 1-4 family non-owner occupied real estate

Distribution of Credit Unions by First-Lien Real Estate Loans to Assets (Credit Unions > \$100 Million)



Distribution of Credit Unions by Other Real Estate Loans to Assets (Credit Unions > \$100 Million)



Commercial Loans

	Part 723 MBL	Proposed Part 702 RBC
Type of loan	Member Business Loan	Commercial Loan
1-4 family non-owner occupied residential real estate	Included in cap	Residential real estate risk weight
Vehicles generally manufactured for personal use	Included in cap if business purpose	Consumer risk weight if not fleet or fare-paying
Business purpose loans	Included in cap if greater than \$50,000	Commercial risk weight for all

- **Compensating balances and government guarantees**
 - Lower risk weight
 - Do not count towards concentration risk threshold

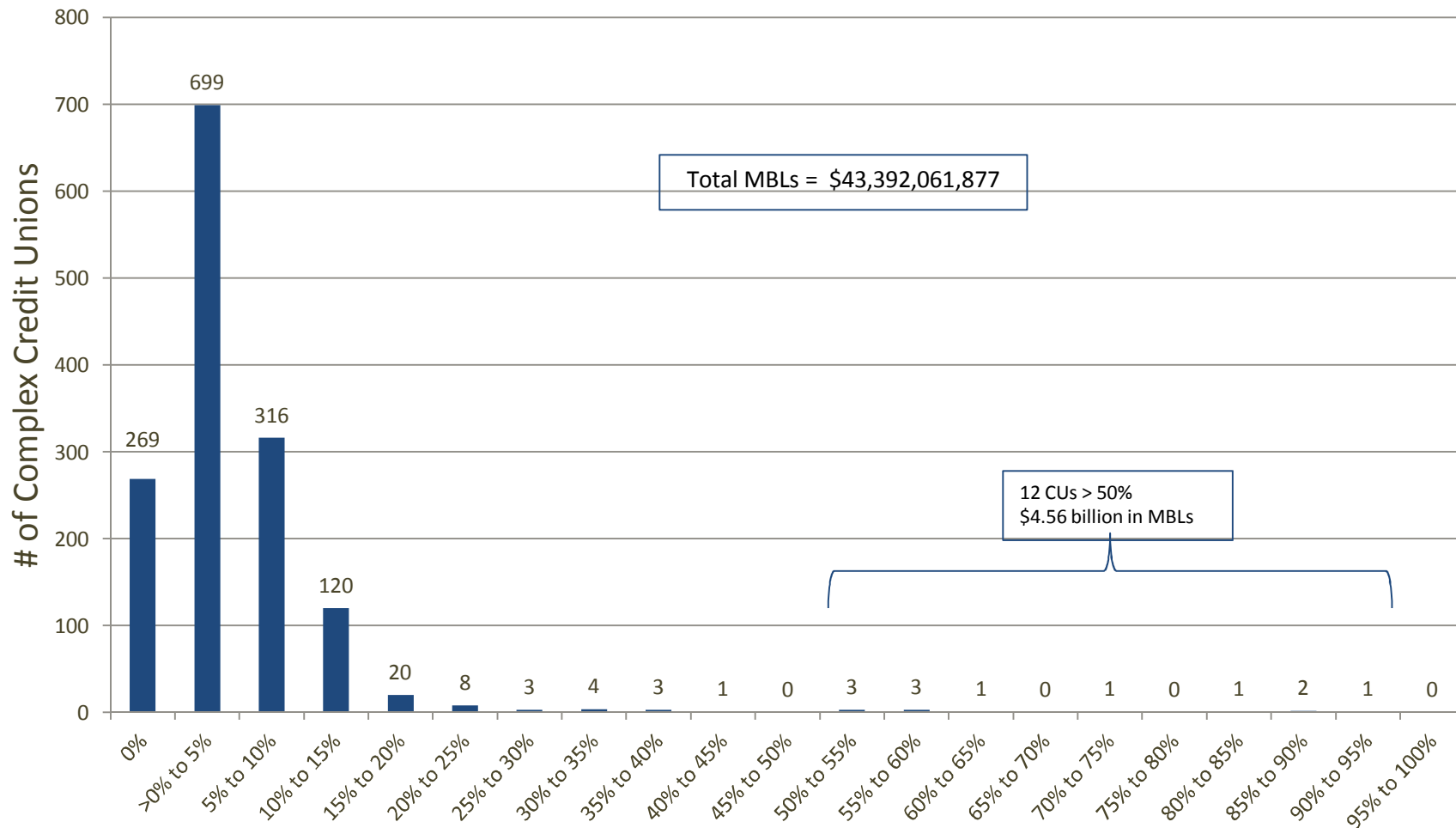
Commercial Loans

	Original Proposal	Revised Proposal	Bank Rules
Commercial Loans < 50% of Assets	MBLs < 15% of Assets: 100%, 15%-25% of Assets: 150% > 25% of Assets: 200%	100%*	100-150%**
Commercial Loans > 50% of Assets	MBLs > 25% of Assets: 200%	150%*	100-150%**
Non-Current Commercial Loans	Included with Current MBL	150%	150%

*100% (excludes 1-4 family non-owner occupied RE loans and any loan secured by vehicles manufactured for personal use)

**High Volatility Commercial Real Estate Loans are assigned a risk weight of 150%

Distribution of Credit Unions by MBLs to Assets (Credit Unions > \$100 Million)



CUSOs

	Original Proposal	Revised Proposal	Bank Rules
Loans to CUSOs (Unconsolidated Only)	100%	100%	100%
Investments in CUSOs (Unconsolidated Only)	250%	150%	100-600%

- For consolidated, wholly-owned CUSOs, loans and investments in CUSOs would be assigned a risk weight on a consolidated basis
- For unconsolidated CUSOs, lower risk-weight for investments in CUSOs

Off-Balance Sheet Items

- **Key Changes:**

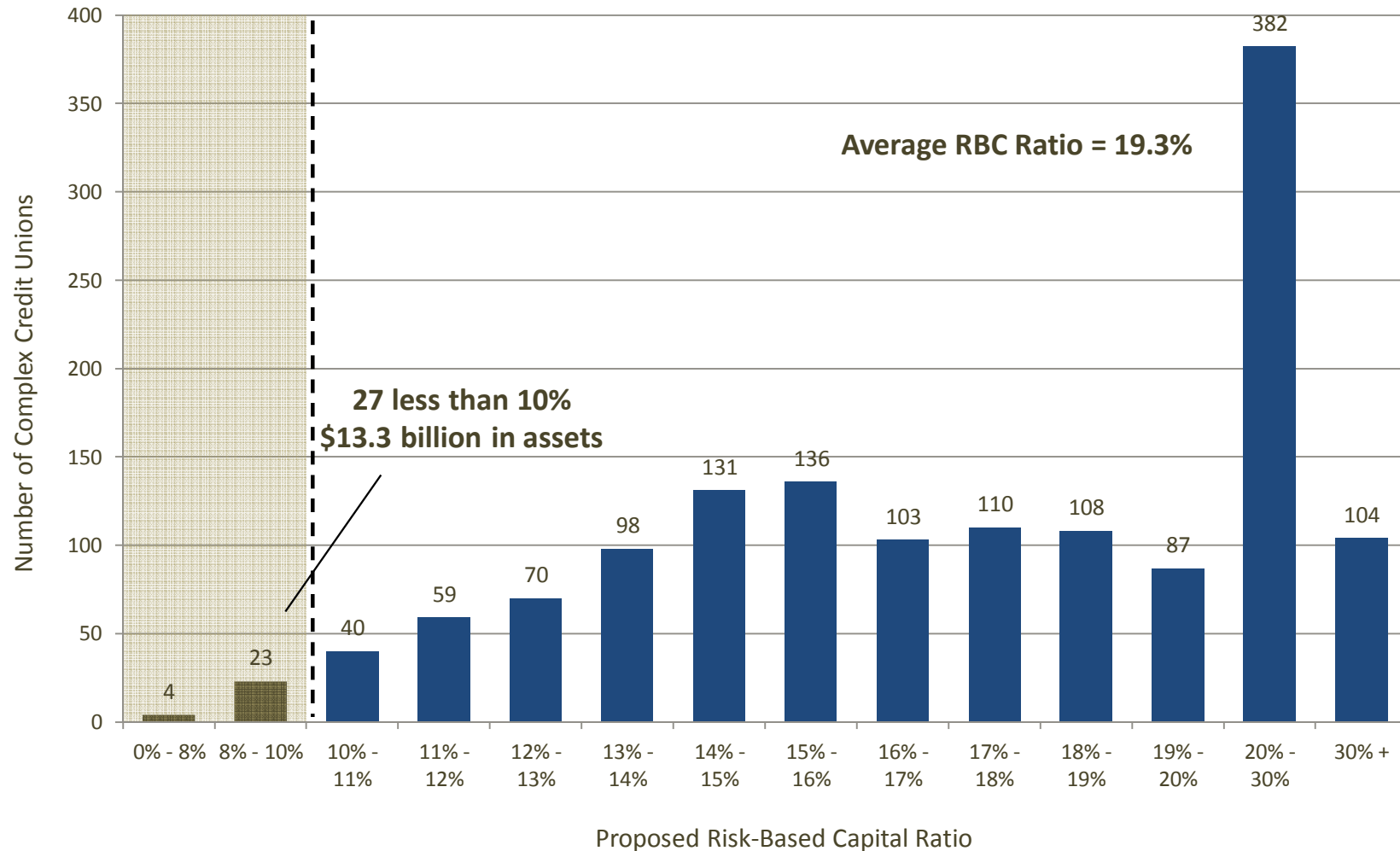
- Maximum exposure amount (instead of outstanding face value) will be multiplied by the credit conversion factor to determine the credit equivalent amount,
- FHLB Mortgage Partnership Finance Program Loans will be calculated using the outstanding balance multiplied by a lower credit conversion factor
- Lower risk weight for commercial unfunded commitments from 75 percent to 50 percent.

Other Items

- **Mortgage Servicing Assets**
 - Retained 250% risk weight
- **Derivatives**
 - Comparable to FDIC

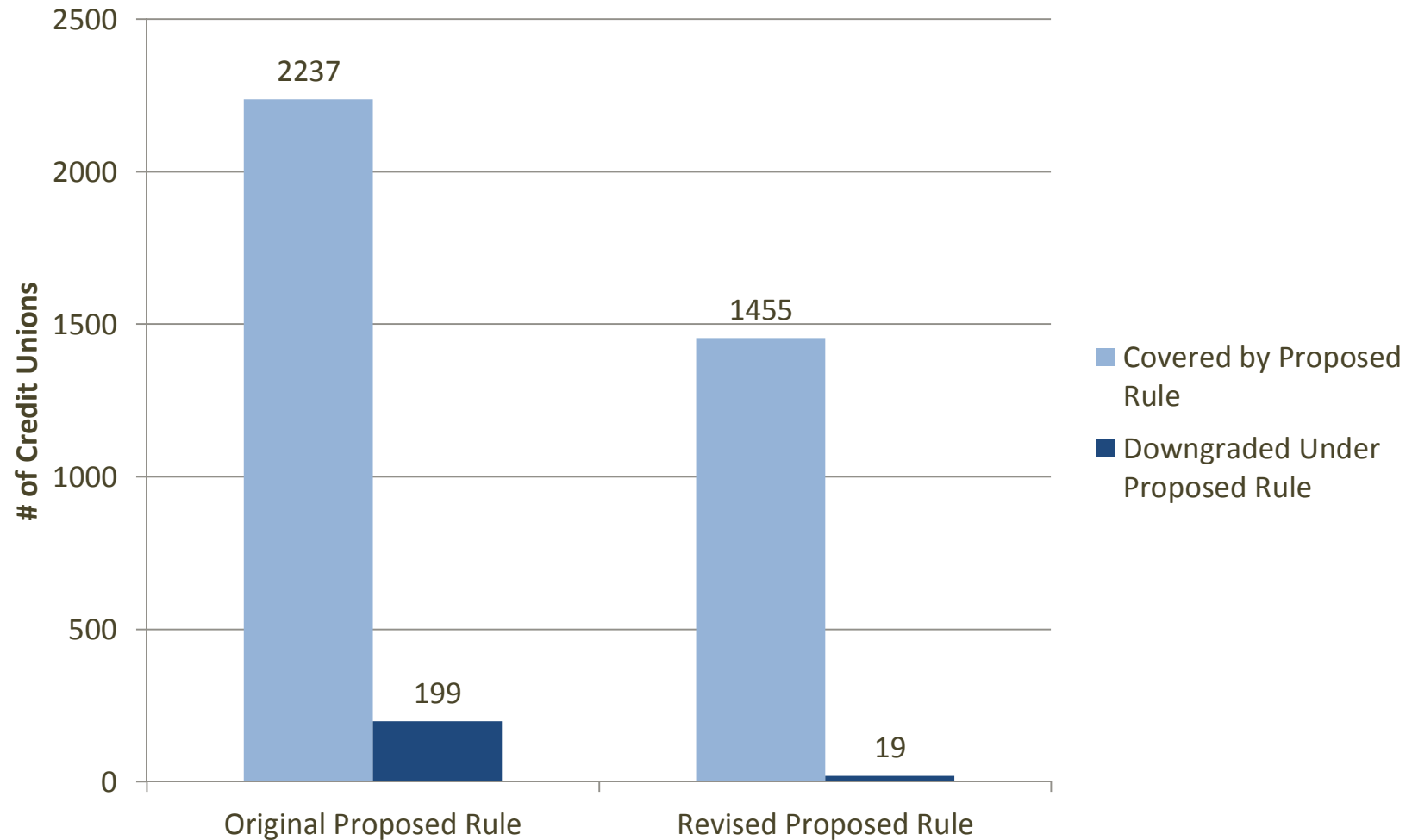
Proposed Risk-Based Capital Ratios

Distribution of Complex Credit Unions

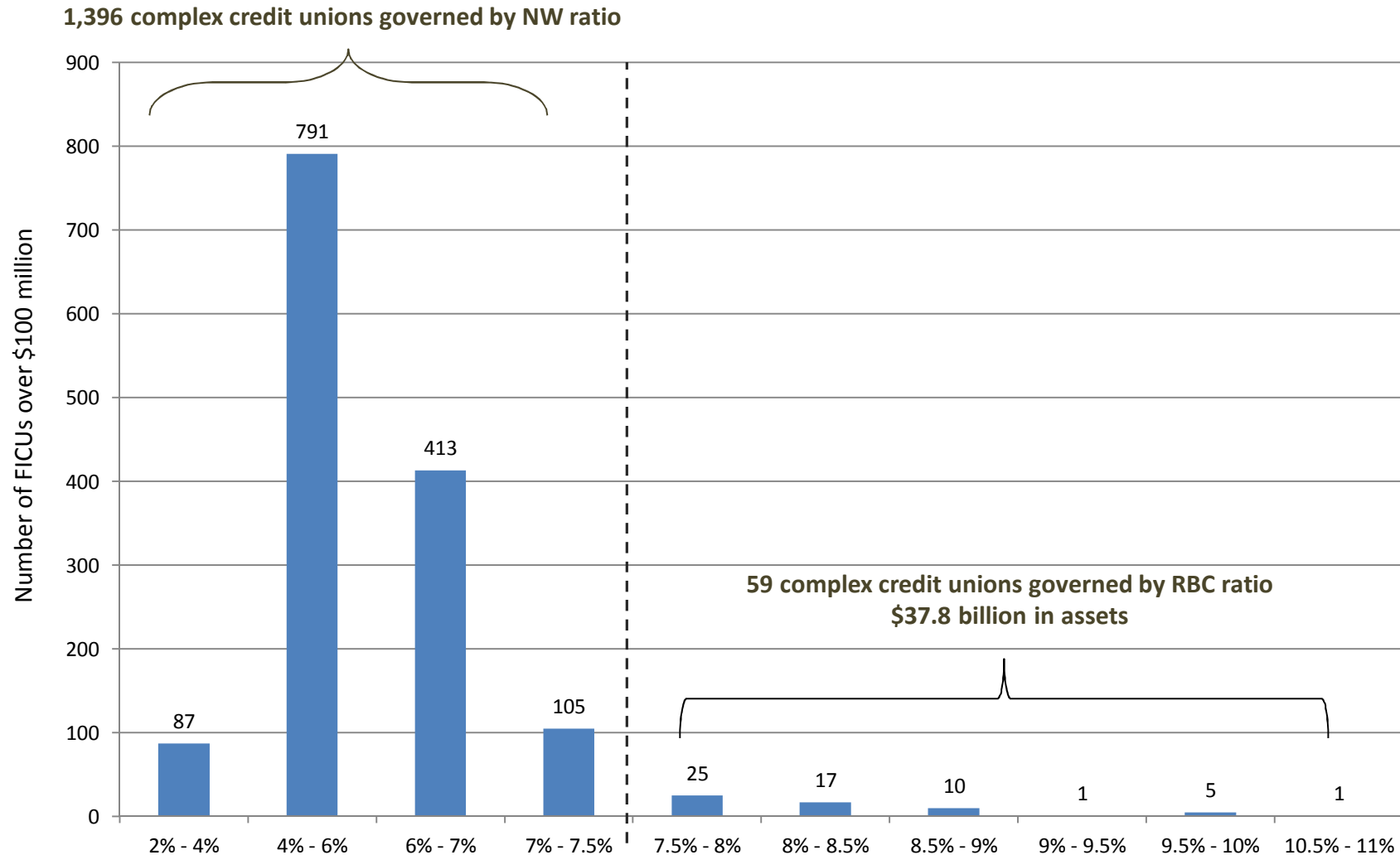


Impact on PCA Classification

For Complex Credit Unions

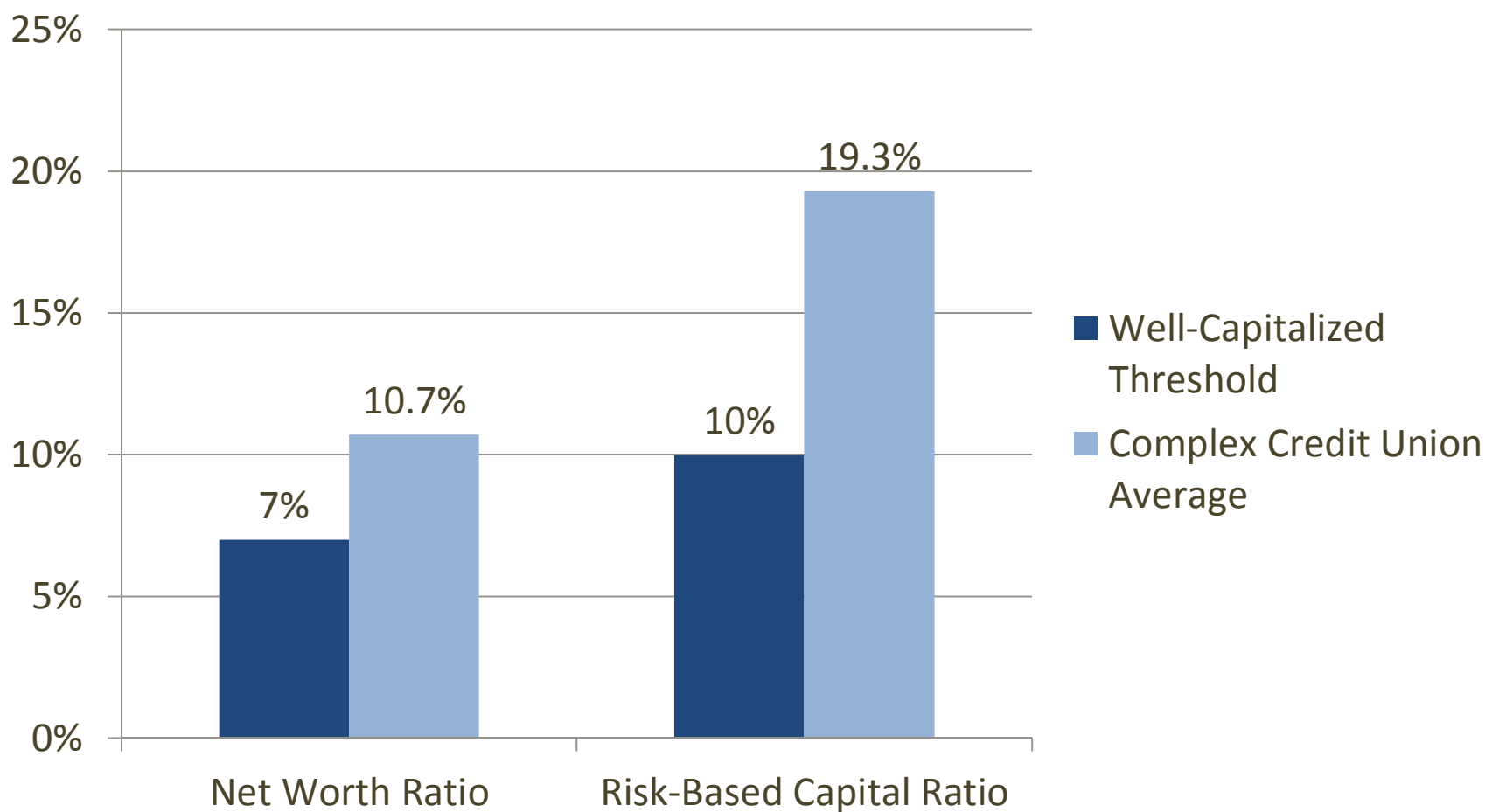


Which Ratio Governs



Proposed RBC Leverage Equivalent = 10% of Risk Assets/Total Assets

PCA Ratio Comparison



Goals of a Risk-Based Capital Framework

- Make sure larger, more complex credit unions remain well-capitalized as they grow and expand
- Incorporate a modern approach to calculating risk-based capital ratio, which is comparable to other financial institutions
- Enable credit unions to continue to be able to lend during time of economic distress

What's Next?

90 Day Comment Period



Final Rule



Call Report Changes



Extended Implementation

Q&A

